STATE OF MICHIGAN

IN THE SUPREME COURT

NATIONAL WINE & SPIRITS, INC.,
NWS MICHIGAN, INC., and
NATIONAL WINE & SPIRITS, L.L.C.,

Plaintiff-Appellants

v

STATE OF MICHIGAN,

Defendant-Appellee

and

MICHIGAN BEER & WINE
WHOLESALERS ASSOCIATION,

Intervening Defendant-Appellee.

Supreme Court No. 126121

Court of Appeals
No. 243524

Circuit Court for the County of
Ingham No. 02-13-CZ

ORAL ARGUMENT REQUESTED

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APPELLANTS' BRIEF ON APPEAL

TABLE OF CONTENTS

MILLER, CANFIELD, PADDOCK AND STONE, P.L.C.

TABLE OF CONTENTS
(continued)

INDEX OF AUTHORITIES

CASES

STATUTES

CONSTITUTIONAL PROVISIONS

STATEMENT OF BASIS OF JURISDICTION

This appeal is from an opinion of the Court of Appeals dated March 25, 2004 that affirmed the trial court's granting of Defendant-Appellees' Joint Motion for Summary Disposition which dismissed this case; this Court therefore has jurisdiction pursuant to MCR 7.301(2). This Court entered an Order granting Plaintiff-Appellants' Application for Leave to Appeal on January 20, 2006, after hearing oral arguments on the application on January 11, 2006.

STATEMENT OF QUESTIONS INVOLVED

I. Does MCL 346.1205(3) ("§ 205(3)") violate the Commerce Clause of the United States Constitution?

The trial court answered "No."
The Court of Appeals answered "No."
Appellants answer "Yes."

II. Does § 205(3) violate the Equal Protection Clauses of the United States and Michigan Constitutions?

The trial court answered "No."
The Court of Appeals answered "No."
Appellants answer "Yes."

INTRODUCTION

This action arises out of the State's efforts to privatize the distribution of spirits in 1996.[1] Before this privatization effort, spirits were owned and delivered by the State. The privatization effort was undertaken to relieve the State of the burden of warehousing and delivering spirits. After passage of the privatization statute, the State no longer warehouses or delivers spirits, it only owns them. As required by the new privatization laws (designed solely for spirits and not beer or wine), the State appointed Authorized Distribution Agents ("ADAs") to warehouse and distribute State-owned cases of spirits, i.e., in a principal/agent relationship. This case challenges the validity of one part of the Michigan Liquor Control Code of 1998, MCL 436.1101 *et seq*. (the "1998 Code"), which was enacted in connection with this privatization effort. As is shown in detail below, the challenged part of the 1998 Code, § 205(3), MCL 436.1205(3), ("§ 205(3)")(Appendix 19a-20a), fails each of two alternative tests developed by the U.S. Supreme Court to determine if a state law violates the Commerce Clause. These two tests are: (1) The Discrimination Test – If a statute unlawfully discriminates in favor of local businesses and cannot survive "strict scrutiny" it is effectively a *per se* violation of the Commerce Clause and (2) The Undue Burden Test – If a statute places an undue burden on interstate commerce without furthering a legitimate state interest, it will be declared unconstitutional, even if it does not discriminate against out-of-state companies.

This case essentially implicates four categories of businesses involved in the alcoholic beverage industry in Michigan. The first, second and third categories – (1) wine wholesalers licensed prior to September 24, 1996 ("pre-1996 wholesalers"), (2) wine wholesalers licensed after September 24, 1996 ("post-1996 wholesalers"), and (3) wine wholesalers licensed prior to

[1] "Spirits" are defined in the Michigan Liquor Control Code of 1998 as "a beverage that contains alcohol obtained by distillation, mixed with potable water or other substances, or both, in solution, and includes wine containing an alcoholic content of more than 21% by volume, except sacramental wine and mixed spirit drink." MCL 436.1111(13).

September 24, 1996 that are or become ADAs ("pre-1996 ADA/wholesalers")[2] - are favored by Michigan law. The fourth category – wholesalers licensed after September 24, 1996 that are or become ADAs ("post-1996 ADA/wholesalers")[3] - suffer a distinct disadvantage by the operation of § 205(3), as illustrated by the chart below.

	Pre-1996 Wholesaler*	Post-1996 Wholesaler*	Pre-1996 ADA/Wholesaler*	Post-1996 ADA/Wholesaler
Can sell "new" wine[4]	YES	YES	YES	YES
Can "dual"[5]	YES	YES	YES	**NO**

* There are no out-of-state companies or individuals in any of these classes, only Michigan companies and residents.

Specifically, § 205(3) discriminates against Plaintiffs[6] and all other post-1996 ADA/wholesalers, because it allows Michigan wine wholesalers to become ADAs and continue to sell all the brands of wine they were selling on September 24, 1996, even if another wholesaler sells the same wine, while at the same time prohibiting out-of-state ADA/wholesalers from selling any wines already being sold by any other wine wholesaler in Michigan. There is no dispute that this is an incredible advantage for the in-state ADA/wholesalers, an advantage that makes it virtually impossible for any out-of-state ADA/wholesaler to compete in Michigan. The Michigan Beer and Wine Wholesalers Association ("MBWWA") lobbied to obtain this advantage, and has intervened in this action in an effort to protect it.

Even if this Court were to determine that § 205(3) does not discriminate against out-of-state companies, this statute must still be invalidated because it places an undue burden on

[2] While this simplistic label is used throughout for ease of reading, it should be noted that there were no ADAs pre-September 24, 1996, the category of pre-1996 wholesaler/ADAs means that the company became a wholesaler prior to September 24, 1996 and an ADA at some time after that date.
[3] This category includes all out-of-state ADA/wholesalers, like Plaintiff-Appellants.
[4] "New" wine is wine that is not already being sold by another wholesaler or wholesaler/ADA.
[5] "Dualing" is allowing another wholesaler to compete for a brand already being sold in an area. All wine wholesalers in Michigan are allowed to dual except those who became wholesalers and ADAs after September 24, 1996.
[6] Plaintiff-Appellants, National Wine and Spirits, Inc., NWS Michigan, Inc., and National Wine and Spirits, LLC are referred to collectively as "Plaintiffs."

interstate commerce. This statute violates the Commerce Clause because the state interest proffered by Defendants[7] has no other purpose than to protect the economic interests of all local wine wholesalers at the expense of out-of-state ADAs. The U.S. Supreme Court has made it clear that "where simple economic protectionism is affected by state legislation 'a strict rule of invalidity must be applied.'"[8] Protecting one economic group from competition from another is not a legitimate state purpose and will not support a statute that otherwise impedes interstate commerce.

During oral argument heard by this Court on Plaintiffs' Application for Leave to Appeal, it appeared that some members of the Court had concerns that § 205(3) also adversely impacts some in-state ADA/wholesalers, specifically, any "future" in-state wholesaler that becomes licensed after September 24, 1996, and who wishes to become an ADA as well. The Court's question appears to be, *how can § 205(3) be discriminatory if it negatively affects both out-of-state and in-state companies*? The answer to this question is straightforward: Laws that negatively impact all out-of-state companies and some in-state companies violate the Commerce Clause, as long as they favor other in-state companies. This Commerce Clause precept was recently confirmed by the U.S. Supreme Court:

> The ordinance is no less discriminatory because in-state or in-town processors are also covered by the prohibition...The only conceivable distinction from the cases cited above is that the flow control ordinance favors a single local proprietor. ***But this difference just makes the protectionist effect of the ordinance more acute.***

C&A Carbone, Inc v Town of Clarkstown, NY, 511 US 383 at 391-392; 114 S Ct 1677; 128 L Ed 2d 399 (1994)(emphasis added).

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[7] Defendant-Appellee State of Michigan and Intervening Defendant-Appellee Michigan Beer and Wine Wholesalers Association are referred to collectively as "Defendants."

[8] *Bacchus Imports Ltd v Dias*, 468 US 263, 270; 104 S Ct 3049; 82 L Ed 2d 200 (1984).

Here § 205(3) is protecting two of the largest wine wholesalers in the state from any serious competition, whether from in-state or out-of-state wine wholesalers. Just as in *Carbone*, § 205(3) is no less discriminatory merely because some other in-state companies suffer along with the out-of-state companies. It still discriminates against interstate commerce because all out-of-state companies, without exception, will be negatively impacted, while at the same time, at least two Michigan companies will be treated more favorably. Just as in *Carbone,* § 205(3) must be invalidated.[9]

This Court also asked whether Plaintiffs were asserting that § 205(3) was discriminatory on its face or as it is applied. As shown below, Plaintiffs are making ***both*** arguments, and note further that in either case, there are ample grounds for declaring § 205(3) unconstitutional. Plaintiffs believe that when the 1998 Code is read as a whole, § 205(3) is discriminatory on its face because the only entities that could legally benefit from the statute's discriminatory provisions are residents of the State of Michigan. This is because § 601 of the 1998 Code required all wine wholesalers to be state residents for a year before obtaining a wholesaler's license. Thus, only Michigan resident wholesalers who become ADAs are able to keep selling all the wines they were selling on September 24, 1996 (the ostensibly arbitrary date set by § 205(3)), while no one who becomes a wholesaler/ADA after that date – which includes all out-of-state ADAs – can sell a wine unless it is a brand newly introduced to the state or it is a brand that is discarded by some other wholesaler.[10] Thus, the law, ***on its face***, is discriminatory.

[9] Laws that benefit one class while denying those same benefits to future members of the same class also violate the Equal Protection Clauses of the United States and Michigan Constitutions. See *Hertel v Racing Com'r, Dept of Argiculture*, 68 Mich App 191; 242 NW2d 526 (1976), discussed *infra*.

[10] As noted in the Preliminary Commerce Clause Analysis submitted by Anderson Economic Group in support of Plaintiffs' Motion for Summary Disposition "[T]he protected market for in-state ADA/wholesalers that can distribute 'old' wine is substantial, and cannot be easily overcome by merely selling competing fine wines." Appendix 111a.

But the undisputed facts presented to the trial court also established that § 205(3), ***as applied***, discriminates against out-of-state entities. For whatever reason, ***every*** wine wholesaler in Michigan on September 24, 1996, was in fact a Michigan resident, and no out-of-state companies were licensed wholesalers on this date. Thus, it is undisputed that under § 205(3), only Michigan residents were able to obtain the advantage of keeping every wine they were selling on that date, while also competing for any new wines, while every out-of-state company that wanted to be a wine wholesaler/ADA could only compete for new wines. Thus, this statute had the real world impact of protecting only Michigan residents from its adverse effects, while at the same time imposing those adverse effects on every out-of-state company seeking to be a wine wholesaler/ADA in Michigan. As it was and is applied, § 205(3) discriminates against interstate commerce.

Finally, Plaintiffs show below that § 205(3) also violates the Equal Protection clause of both the United States and Michigan constitutions. Section 205(3) sets up at least two classifications based on nothing other than the date September 24, 1996, and bestows favors on the pre-1996 class that it denies to the post-1996 class. The "rational basis" proffered by the State – that it seeks to protect local wine wholesalers – is no more legitimate in an Equal Protection argument than it is in a Commerce Clause argument.

For these reasons, and the other reasons set forth in full below, § 205(3) should be declared unconstitutional and void.

STATEMENT OF FACTS

I. Michigan Liquor Regulation

Following the repeal of prohibition by the adoption of the Twenty-first Amendment to the United States Constitution, the Michigan Legislature enacted the Michigan Liquor Control

Act of 1933 ("1933 Act"), under which there were no private distributors of spirits in the State of Michigan and the State itself, through the Liquor Control Commission ("Commission"), purchased spirits from suppliers and distributed the product to licensed retail outlets. The State followed a standard model used by numerous other states when developing its liquor distribution system. This model, frequently referred to as a "three-tiered system," intended to keep the manufacturers/importers of alcoholic beverages, the in-state wholesalers, and the in-state retailers all separate and distinct, so that a member of one tier could not exert any affiliation or control over a member of a different tier. Thus, for example, manufacturers could not be wholesalers or retailers. This alleviated the problems historically caused by "tied-house" arrangements which allowed manufacturers to dictate the prices for which their products would be sold at both the wholesale and retail levels. This historical purpose was described by the California Supreme Court in *California Beer Wholesalers Association, Inc v Alcoholic Beverage Control Appeals Board*, 5 Cal 3d 402, 407-408; 487 P2d 745; 96 Cal Rptr 297 (1971):

> Following repeal of the Eighteenth Amendment, the vast majority of states, including California, enacted alcoholic beverage control laws. These statutes sought to forestall the generation of such evils and excesses as intemperance and disorderly marketing conditions that had plagued the public and the alcoholic beverage industry prior to prohibition. By enacting prohibitions against "tied-house" arrangements, state legislatures aimed to prevent two particular dangers: the ability and potentiality of large firms to dominate local markets through vertical and horizontal integration and the excessive sales of alcoholic beverages produced by the overly aggressive marketing techniques of larger alcoholic beverage concerns.
>
> The principal method utilized by state legislatures to avoid these antisocial developments was the establishment of a triple-tiered distribution and licensing scheme. Manufacturing interests were to be separated from wholesale interests; wholesale interests were to be segregated from retail interests. In short, business endeavors engaged in the production, handling, and final sale of alcoholic beverages were to be kept "distinct and apart."
>
> In the era when most tied-house statutes were enacted, state legislatures confronted an inability on the part of small retailers to cope with pressures

> exerted by larger manufacturing or wholesale interests. Consequently, most of the statutes enacted during this period (1930-1940) manifested a legislative policy of controlling large wholesalers; the statutes were drafted in sufficiently broad terms, moreover, to insure the accomplishment of the primary objective of the establishment of a triple-tiered system. All levels of the alcoholic beverage industry were to remain segregated; firms operating at one level of distribution were to remain free from involvement in, or influence over, any other level. (citations and footnotes omitted)

Thus, the three-tiered system was designed to foster orderly markets[11] and promote temperance, not by discouraging competition among the members of any given tier, but by prohibiting the involvement of one tier in the business of another.

Sixty-three years after the State enacted its first liquor laws, the State ended its direct role in warehousing and distribution functions for spirits, and in its stead adopted a system where ADAs handled these functions (in the case of beer and wine, such functions had always been handled by the private sector, under strict regulation). Under the privatized system, ADAs serve as agents of the Commission and the Commission maintains oversight responsibility.

The State of Michigan sought and received assistance from National Wine and Spirits, Inc. ("National") with respect to privatizing spirits distribution in Michigan. See Affidavit of Steve Null ("Null Affidavit"), Appendix 33a-37a. National was able to provide such assistance to the State because of its extensive experience with spirits distribution in other states. As of 1996, National was the largest distributor of spirits in Indiana and one of the largest distributors of spirits in Illinois. *Id.*

At the time this lawsuit was filed in 2002, National had invested approximately $25 million in the State of Michigan for the creation of a system of warehousing and delivery of spirits. *Id.* National's investment in the State has grown since that date. National created a wholly owned subsidiary (NWS Michigan, Inc.) for purposes of spirits distribution in Michigan.

[11] The concept of orderly markets was developed as a result of the disorder experienced during prohibition, i.e., smuggling, hi-jacking, etc.

NWS Michigan, Inc. became incorporated in Michigan on October 21, 1996 and became an ADA for the State of Michigan on or about December 22, 1996. *Id.* The State admits that as part of the privatization efforts, NWS Michigan, Inc. extended offers of employment to 116 Commission employees, 94 of whom accepted employment. See Defendant's Answer to Complaint for Declaratory Judgment, ¶ 21 ("Answer"), Appendix 23a-32a.

When the State privatized warehousing and delivery of spirits in 1996, it passed legislation which imposed a number of eligibility and operational restrictions on ADAs. See MCL 436.1205. At the time the Michigan Legislature passed this legislation, it is likely that potential in-state ADAs knew that NWS Michigan, Inc. was poised to become the largest and only out-of-state ADA in Michigan and that it was the wholly owned subsidiary of an out-of-state company, National Wine & Spirits, Inc. Null Affidavit, Appendix 35a. It is also likely that in-state ADAs encouraged the Michigan Legislature to enact legislation that would effectively exclude NWS Michigan Inc. and other out-of-state ADAs from serving in the combined role of an ADA of spirits and as a licensed wholesaler of wine. *Id.*

The Michigan Legislature did in fact include a provision in the privatization legislation which restricts an out-of-state company from effectively serving as both an ADA of spirits and a licensed wine wholesaler in the State of Michigan. This provision, now § 205(3), prohibits a post-1996 ADA/wholesaler, from selling or distributing a brand of wine in an area in which a wholesaler has already been assigned or authorized to sell or distribute that brand of wine ("dualing prohibition").[12] See § 205(3). *The dualing prohibition in § 205(3) does not apply, however, to the sale of a brand of wine by a pre-1996 ADA/wholesaler who was selling that particular brand in the relevant area on or before September 24, 1996.*

[12]"Dualing," where a wine wholesaler is permitted to compete for specific wine brands in a given territory, even though other wholesalers are already selling that same brand, is the norm in Michigan—except post-1996 ADA/wholesalers after September 24, 1996, who can never dual.

It is not disputed that on September 24, 1996, only in-state companies were licensed as wine wholesalers in the State of Michigan. See Answer, ¶ 30, Appendix 27a. Prior to September 24, 1996, ***every brand of wine*** then being sold in Michigan was already assigned to one or more wine wholesalers, including some wine wholesalers who later became ADAs. As a result, the dualing prohibition in § 205(3) has minimal effect on in-state ADA/wholesalers, while at the same time it effectively prohibits all out-of-state companies from serving as both an ADA of spirits and a licensed wholesaler of wine in Michigan. This is because, of the wines being sold today, approximately 97% of the brands were already being sold on September 24, 1996 by in-state wholesalers, Affidavit of Gregory Mauloff ("Mauloff Affidavit"), Appendix 122a-123a,[13] and would therefore be unavailable to any out-of-state ADA/wholesaler because of § 205(3). The dualing prohibition undermines the interests of the State by hampering the ability of some of its ADAs to distribute State-owned spirits, and also directly conflicts with the general policy enunciated in the 1998 Code which permits and encourages competition among wine wholesalers by allowing wine suppliers to "grant the right to sell a specified brand or brands in a sales territory to more than 1 wholesaler." See MCL 436.1307(1), Appendix 21a.

II. <u>Section 205(3) Effectively Prohibits Plaintiffs' Entry Into The Wine Wholesaling Market</u>

National Wine & Spirits, L.L.C. (a wholly-owned subsidiary of National Wine & Spirits, Inc.) obtained a wine wholesaling license on November 12, 1999. Null Affidavit, Appendix 35a-

[13]This percentage is confirmed by the Updated Commerce Clause Analysis submitted by Anderson Economic Group ("Anderson") which is attached at Appendix 154a-210a. Although this updated analysis was not part of the record below, Anderson's Preliminary Commerce Clause Analysis (Appendix 104a-121a) was provided in support of Plaintiffs' Second Motion for Summary Disposition. Given the passage of time since the first report was offered (four years), Plaintiffs submit the updated analysis to assist the Court in understanding the effect of § 205(3) on Plaintiffs' ability to compete with ADA/wholesalers who have the advantage of selling wines they sold pre-1996. This report makes it clear that the predictions by Defendants that non-resident ADA/wholesalers would be able to compete by selling only new brands that come on the market is pure speculation not supported by any facts.

36a. The dualing prohibition applies to National Wine & Spirits, L.L.C. because National Wine & Spirits, L.L.C. obtained its wine wholesaling license after September 24, 1996, see MCL 436.1205(3), and because it is a subsidiary of the same parent company as NWS Michigan, Inc., an ADA.[14] National Wine & Spirits, Inc. and National Wine & Spirits, L.L.C. have lost substantial revenue by not being permitted to sell and distribute popular brands of wine in the State of Michigan. Null Affidavit, Appendix 37a.

III. Section 205(3) Effectively Prohibits Plaintiffs From Developing And Sharing Combined Cost Economies

All companies that were licensed as wine wholesalers prior to September 24, 1996 can become ADAs of spirits, and in fact, two of these companies, General Wine Co. ("General") and Trans-Con, Co. ("Trans-Con"), have become ADAs.[15] Companies that serve as licensed wine wholesalers and ADAs are able to and have developed cost economies as a result of their ability to act both as ADAs and wine wholesalers ("combined cost economies"). This is admitted by the State. Answer, ¶ 40, Appendix 28a. One such combined cost economy is developed when a company delivers spirits and wine to retailers on the same truck. Companies that serve as licensed wine wholesalers and ADAs are able to and do pass on to their suppliers the benefits of combined cost economies. See generally, Null Affidavit, Appendix 33a-37a.

Plaintiffs and other out-of-state companies are unable to develop or share with their suppliers combined cost economies because § 205(3) effectively prohibits them from serving in a combined role. Plaintiffs have lost substantial revenue because a number of their suppliers have cancelled contracts and have switched to in-state companies that are permitted to develop and

[14] As noted in the Null Affidavit, the Commission has taken the position that National Wine & Spirits, L.L.C. and NWS Michigan, Inc., as subsidiaries of National Wine & Spirits, Inc., are essentially alter egos. Since NWS Michigan, Inc. is an ADA, according to the Commission, National Wine & Spirits, L.L.C. must also be treated as if it were an ADA.

[15] These two companies handle approximately 70% of the wholesale business in the State of Michigan. Affidavit of Gregory J. Mauloff, Appendix 123a.

share combined cost economies. Plaintiffs' $25 million plus investment in the State of Michigan is at substantial risk because of their inability to compete on a level playing field with in-state companies that were selling popular and profitable brands of wine before September 24, 1996. See generally, Null Affidavit, Appendix 33a-37a. Not only does this hamper Plaintiffs' ability to sell wine, it negatively impacts their duties as the State's agent to sell spirits because the other ADAs enjoy much greater profits arising from the sale of wine, which profits can be used to promote state-owned spirits to retailers.

IV. The Proceedings Below

This action was brought only against the State of Michigan as the action seeks to have a state statute declared unconstitutional. The MBWWA intervened over the objection of Plaintiffs. On May 8, 2002, a hearing was held on Plaintiffs' Motion for Summary Disposition which sought to have § 205(3) declared unconstitutional based on the Equal Protection clause. Noting that "[a] statute is presumed to be constitutional and the Plaintiffs bear a very heavy burden, and I think in this case they come close. They don't quite make that burden, don't quite shoulder that burden," the trial court denied Plaintiffs' Motion for Summary Disposition. Transcript of May 8, 2002 hearing on Plaintiffs' Motion for Summary Disposition, ("Tr. May 8"), Appendix 82a.

After Plaintiff's Motion for Summary Disposition was denied, Defendants submitted a Joint Motion for Summary Disposition. On August 14, 2002, a hearing was held on Defendants' Joint Motion for Summary Disposition. Plaintiffs argued, *inter alia*, that under the Commerce Clause the State's burden of showing a legitimate purpose and method for achieving that purpose was much heavier than under the Equal Protection analysis. Nevertheless and despite the trial court's earlier conclusion that Plaintiffs had come "very close" to meeting their burden of showing that there was no rational basis for § 205(3), the court granted the motion, dismissing the case in its entirety. Transcript of August 14, 2002 Hearing on Defendants' Joint Motion for Summary Disposition ("Tr. August 14"), Appendix 143a.

Plaintiffs appealed. The Court of Appeals' opinion affirming the trial court was issued March 25, 2004. *National Wine & Spirits, Inc. v State of Michigan*, unpublished opinion per curiam of the Court of Appeals, issued March 25, 2004 (Docket No. 243524). Appendix 146a-153a.

Plaintiffs filed their application for leave to appeal to this Court on May 6, 2004. The Court held the appeal in abeyance pending the decision of the U.S. Supreme Court in *Granholm v Heald*, 544 US 460; 125 S Ct 1885; 161 L Ed 2d 796 (2005)[16], the case which ultimately determined that the Twenty-first Amendment of the U.S. Constitution does not trump the Commerce Clause, and that a state cannot ignore the mandates of the Commerce Clause when adopting laws that regulate the sale and distribution of alcoholic beverages. After *Granholm* was decided, this Court heard oral argument on the application for leave to appeal on January 11, 2002, and granted the application on January 20, 2006.

ARGUMENT

I. THE STANDARD OF REVIEW IS DE NOVO

This Court reviews the granting or denial of a motion for summary disposition *de novo. Schmalfeldt v Northpoint Ins Co*, 469 Mich 422, 426; 670 NW2d 651 (2003), citing *First Public Corp v Parfet*, 468 Mich 101, 104; 658 NW2d 477 (2003). Further, the constitutionality of a statute is a question of law that is reviewed *de novo. Phillips v Mirac*, 470 Mich 415, 442; 685 NW2d 174 (2004). This standard of review applies to both the Commerce Clause and Equal Protection Clause arguments presented in this Appeal.

[16] The U.S. Supreme Court decision in this case will be referred to as "Granholm." The U.S. Circuit Court of Appeals for the Sixth Circuit decision that was affirmed by Granholm, *Heald v Engler*, 342 F3d 517 (CA6, 2003), will be referred to as "Heald."

II. SECTION 205(3) VIOLATES THE COMMERCE CLAUSE

A. The Granholm Decision Confirms That The Twenty-first Amendment Does Not Relieve The State Of Its Obligations Under The Commerce Clause

Just as they did in *Granholm*, Defendants here rely heavily on the argument that the Twenty-first Amendment to the U.S. Constitution gives the State the unfettered right to regulate every aspect of the alcoholic beverage trade, even if that regulation is protectionist and would otherwise violate the Commerce Clause of the same Constitution. The trial court agreed with this proposition. Tr. August 14, Appendix 141a-142a. This argument was soundly rejected by the Supreme Court in *Granholm*, a case which struck down Michigan's prohibition of the direct shipment of out-of-state wines:

> Our more recent cases, furthermore, confirm that the Twenty-first Amendment does not supersede other provisions of the Constitution and, in particular, does not displace the rule that States may not give a discriminatory preference to their own producers.

Granholm, 125 S Ct at 1903.

It is now beyond question that the position consistently taken by Plaintiffs in this case – that the Twenty-first Amendment does not relieve the State of its burden of proof under the Commerce Clause to affirmatively establish that any discriminatory law actually furthers a legitimate state interest and that there is no less discriminatory alternative for accomplishing the legitimate ends of the State – is the law across the land. Here, the State has made no showing whatsoever that it is necessary or effective to give wine wholesalers resident in Michigan on September 24, 1996, a huge competitive advantage over non-resident ADAs who seek to become wine wholesalers. Without such a showing, just as in *Granholm*, the Michigan law challenged in this action must also be struck down.

The State and the MBWWA both argued to the Court of Appeals and this Court that

Granholm was wrongly decided by the U.S. Court of Appeals for the Sixth Circuit. The U.S. Supreme Court instead affirmed the decision of the Sixth Circuit in every respect. This was a gamble that Defendants lost. As a consequence, this Court should apply the precedent established by *Granholm* and declare that the statute in question is unconstitutional and void.

B. <u>The Commerce Clause Analysis</u>

1. Section 205(3) Fails Both Generally Recognized Commerce Clause Tests

The U.S. Supreme Court has inferred from the grant of power given to Congress in Art. I, § 8 of the United States Constitution, which generally gives Congress the power to regulate commerce among the states, that as a necessary corollary to this power, state and local laws which place an undue burden on interstate commerce cannot be upheld. This principle has generally become known as the "Dormant Commerce Clause." The general policy underlying the Commerce Clause was recognized by the *Granholm* Court:

> Time and again this Court has held that, in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Systems, Inc. v. Department of Environmental Quality of Ore.,* 511 US 93, 99; 114 S Ct 1345; 128 L Ed 2d 13 (1994). See also *New Energy Co of Ind v Limbach,* 486 US 269, 274; 108 S Ct 1803; 100 L Ed 2d 302 (1988). This rule is essential to the foundations of the Union. The mere fact of nonresidence should not foreclose a producer in one State from access to markets in other States. *HP Hood & Sons, Inc v Du Mond,* 336 US 525, 539; 69 S Ct 657; 93 L Ed 865 (1949). States may not enact laws that burden out-of-state producers or shippers simply to give a competitive advantage to in-state businesses. This mandate "reflect[s] a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Hughes v Oklahoma,* 441 US 322, 325-326; 99 S Ct 1727; 60 L Ed 2d 250 (1979).

Granholm, 125 S Ct at 1895.

The U.S. Supreme Court generally applies two tests for determining whether a state law violates the Commerce Clause. Under the first test, the Court has held that if a statute discriminates against out-of-state commerce and in favor of in-state commerce, it is practically a *per se* violation of the Commerce Clause. *Id.* at 1897. In such cases, the state can save its law only if that statute survives "strict scrutiny" by showing that the law furthers a compelling state interest, and that there is no other mechanism for advancing that interest. *Id.* at 1905. This is obviously a very high standard for the state to satisfy.

The second test is employed in those circumstances where the state law in question does not actually discriminate against an out-of-state entity in favor of an in-state entity. Where there is no such discrimination, but the statute still places a burden on out-of-state commerce, the courts are required to weigh the state's interest, usually expressed in terms of health, safety and welfare, against the burden imposed on interstate commerce. If the burden outweighs the benefit to the state, then the statute will be declared unconstitutional. Although this is a more subjective analysis, the Supreme Court has drawn a bright line—a state can ***never*** prevail if its interest is merely an attempt to protect its own economy from competition. See generally *Bacchus*, 468 US at 263; see also *Craigmiles v Giles*, 312 F3d 220, 224 (CA6, 2002).

Under either of these tests, § 205(3) must be declared unconstitutional.

a. Section 205(3) Fails the Discrimination Test

If a state statute discriminates against interstate commerce in favor of local commerce, whether the discrimination is apparent from the face of the statute or from its effects, there is a heavy presumption that it violates the Commerce Clause. *Heald*, 342 F3d at 525; *Brown-Forman Distillers Corp v New York State Liquor Authority*, 476 US 573, 579; 106 S Ct 2080; 90 L Ed 2d 552 (1986). The Supreme Court has made it clear that a discriminatory law "invokes the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives." *Hughes v Oklahoma*, 441 US 322, 337; 99 S Ct 1727; 60 L Ed 2d 250 (1979); *Carbone, supra*. Thus if the stated purpose is not served by the discriminatory statute, or even if it is, if there are less discriminatory means for accomplishing the purpose, the statute will be declared invalid.[17] *The burden is on the State to demonstrate that the law in question in fact furthers the purported state interest.* See *Granholm*, 125 S Ct at 1907; *Heald* 342 F3d at 525 and *Fort Gratiot v Michigan Department of Natural Resources,* 504 US 353; 112 S Ct 2019; 119 LEd2d 139 (1992).

(1) Section 205(3) Discriminates on its Face

The discriminatory effect of § 205(3) is obvious when § 205(3) and § 601 are read together. Section 205(3) provides, in pertinent part:

> ...After September 24, 1996, an authorized distribution agent or an applicant to become an authorized distribution agent who directly or indirectly becomes licensed subsequently as a wholesaler shall not be appointed to sell a brand of wine in a county or part of a county for which a wholesaler has been appointed to sell that brand under an agreement required by this act. A wholesaler who directly or indirectly becomes an authorized distribution agent shall not sell or be appointed to sell a brand of wine to a retailer in a county or part of a county for which another wholesaler has been appointed to sell that brand under an agreement required by this act, unless that wholesaler was appointed to sell and was actively selling that brand to retailers in that county or part of that county prior to September 24, 1996....

MCL 436.1205(3). Paraphrased and simplified, this section essentially says:

> ...an [ADA/wholesaler] shall not [dual], unless that wholesaler was appointed to sell and was actively selling [the] brand [it wishes to dual] to retailers in that county or part of that county prior to September 24, 1996....

[17] As will be shown below, § 205(3) does not serve the stated purpose of protecting the "middle tier" of the wine distribution system, but even if it did, there is a better means available that does not unfairly discriminate against interstate commerce.

Section 601 provides:

> (1) A wholesale licensee or an applicant for a wholesale license, if an individual, shall be licensed only if that individual has resided in this state for not less than 1 year immediately prior to the date of issuance of the license.
>
> (2) A wholesale licensee or an applicant for a wholesale license, if a partnership other than a limited partnership, shall be licensed only if all of its members have resided in this state for not less than 1 year immediately prior to the date of issuance of the license.
>
> (3) A wholesale licensee or an applicant for a wholesale license, if a limited partnership, shall be licensed only if the limited partnership is authorized to do business under the laws of this state, and if the general partner and all limited partners have resided in this state for not less than 1 year immediately preceding the date of issuance of the license. If the general partner is a corporation, the limited partnership shall be licensed only if the corporation has been authorized to do business under the laws of this state for not less than 1 year immediately preceding the date on which the corporation obtained an interest in the limited partnership. A limited partnership that holds a wholesale license shall not admit as a new limited partner an individual who has not resided in this state for at least 1 year immediately preceding the date on which the limited partnership interest was acquired by the individual.
>
> (4) A wholesale licensee or an applicant for a wholesale license, if a corporation, shall be licensed only if the corporation is authorized to do business under the laws of this state and if all stockholders of the corporation have resided in this state for not less than 1 year immediately preceding the date of issuance of the license. A corporation that holds a wholesale license shall not issue shares of the corporation's stock to a person who has not resided in this state for at least 1 year immediately preceding the date on which the corporate stock was acquired by the person.

MCL 436.1601. ***As a matter of law*** under § 601 of the 1998 Code (MCL 436.1601)(Appendix 22a) *every wine wholesaler* ***had to be a Michigan resident*** *for a year prior to obtaining its wine wholesalers' license.*[18] Because the various sections of the 1998 Code must be read and

[18] Although Plaintiffs have not expressly challenged § 601, such residency requirements themselves violate the Commerce Clause. See *Cooper v McBeath*, 11 F3d 547 (CA 5, 1994).

construed as one law,[19] the requirement in § 601 that a wine wholesaler be a Michigan company must be incorporated into the language of § 205(3) just as if it had been written there. The facial discrimination can easily be seen when incorporating the residency requirement from § 601 into the simplified version of § 205(3):

> ...an [ADA/wholesaler] shall not [dual], unless that wholesaler was [an instate resident for at least 1 year preceding the date the wholesaler became licensed and was] appointed to sell and was actively selling [the] brand [it wishes to dual] to retailers in that county or part of that county prior to September 24, 1996....

Thus, when § 601 and § 205(3) are read together, the discrimination is apparent. Had § 205(3) expressly limited the right to dual to "Michigan" companies, there would be no question that it violated the Commerce Clause. See *Lewis v BT Inv Managers, Inc*, 447 US 27; 100 S Ct 2009; 64 L Ed 2d 702 (1980) (Statute that prohibited out-of-state holding companies from operating subsidiaries in Florida declared unconstitutional). The fact that the limitation is written in § 601 of the 1998 Code is of no moment for this Commerce Clause analysis.[20] The effect of

[19] In *Waltz v Wyze*, 469 Mich 642, 665-666; 677 NW2d 813 (2004), the Michigan Supreme Court noted that statutory provisions related to the same subject matter should be read in pari materia. In that decision, Justice Young, writing for the majority, quoted *Detroit v Mich Bell Tel Co*, 374 Mich 543, 558; 132 NW2d 660 (1965), where the Michigan Supreme Court explained the rule:

> Statutes in pari materia are those which relate to the same person or thing, or the same class of persons or things, or which have a common purpose. It is the rule that in construction of a particular statute, or in the interpretation of its provisions, all statutes relating to the same subject, or having the same general purpose, should be read in connection with it, as together constituting one law, although enacted at different times...[19]
>
> n19 See also *Dearborn Twp Clerk v Jones*, 335 Mich 658, 662; 57 NW2d 40 (1953)("It is elementary that statutes in pari materia are to be taken together in ascertaining the intention of the legislature, and that courts will regard all statutes upon the same general subject matter as part of 1 system."); *Remus v Grand Rapids*, 274 Mich 577, 581; 265 NW 755 (1936)("'In the construction of a particular statute, or in the interpretation of any of its provisions, all acts relating to the same subject, or having the same general purpose, should be read in connection with it, as together constituting one law.'" [citation omitted].).

[20] The *Heald* court read together several statutory sections to reach the conclusion that the law discriminated against interstate commerce ("As the district court correctly noted, this distinction between in-state and out-of-state wineries can only be understood by reading a number of provisions in conjunction with each other..."). *Heald*, 342 F3d at 520-521.

these two sections of the 1998 Code, when read together, is to prohibit all out-of-state wholesaler/ADAs from ever being able to sell thousands of brands of wine that were being marketed by Michigan wholesalers on September 24, 1996. [21]

(2) Section 205(3), As Applied, Discriminates Against Out-of-State Companies

Even if this Court should conclude that § 205(3) does not discriminate *on its face*, the undisputed facts establish that, *as applied*, § 205(3) does discriminate in favor of Michigan companies. It is not disputed that on September 24, 1996, only in-state companies were licensed as wine wholesalers in the State of Michigan. Answer, ¶ 30, Appendix 27a. As a result of this fact, when § 205(3) was enacted, only in-state companies could receive the benefit of retaining all the wine brands they were representing on September 24, 1996, while no out-of-state company could ever benefit from that provision of the statute. Thus, as a matter of fact, the application of § 205(3) gave a distinct benefit to in-state companies that was denied to out-of-state companies. This is "as applied" discrimination.

(3) Whether The Discrimination is Facial or As Applied, it is Unconstitutional

The impact on interstate commerce of § 205(3)'s discrimination is obvious. As a result, every out-of-state company that may want to become an ADA must decide whether it is worth doing business in Michigan as an ADA if it will necessarily compete with other ADAs who are also wine wholesalers who can sell popular brands of wine that the out-of-state ADA cannot. If

[21] As the Court can imagine, and as set forth in the Affidavit of Gregory J. Mauloff, Appendix 122a-123a, there have not been that many new wines brought to market since 1996, and certainly not that many profitable new wines. This is confirmed by the Updated Commerce Clause Analysis submitted by Anderson Economic Group which is attached at Appendix 154a-210a. This analysis determined that, of the wines being marketed in the United States today, approximately 12.2% of those wines entered the market after 1998. Appendix 188a and 203a. The analysis concludes that any wholesaler restricted to competing for only 12.2% of the wine market will not be able to compete successfully. Appendix 188a.

it is true, as Defendants adamantly assert in this litigation[22], that a wine wholesaler who is not an ADA cannot compete with an ADA/wholesaler because it will not have the same economies that will make it competitive with the ADA/wholesaler, it is also true that an ADA/wholesaler that can only sell limited brands of wine cannot compete with an ADA/wholesaler that can sell all the wines it was selling on September 24, 1996. Thus it is clear that few if any out-of-state companies would be willing to enter the ADA market in Michigan because they will have to compete with the wine wholesalers that are already acting as ADAs, and potentially with any other wine wholesaler that sold wines on September 24, 1996 who at some point in the future decides to become an ADA. Raising such a competitive barrier is precisely the type of conduct prohibited by the Commerce Clause and is the rankest sort of economic protectionism. See *Bacchus*, 468 US at 263, (Court declares state tax on alcoholic beverages unconstitutional because it grants an exception for locally distilled spirits); *Carbone*, 511 US at 383, (Court declares statute unconstitutional because it prohibits out-of-state waste disposal companies from competing for local disposal business); *Cooper*, 447 US at 27, (Court declares Texas residency requirement for mixed beverage permit unconstitutional because it shielded in-state operators from outside competition). Despite this obvious impact on out-of-state commerce, the Court of Appeals inexplicably refused to find that § 205(3) discriminated against interstate commerce.

(4) Section 205(3) Does Not Pass Constitutional Muster Because It Fails Strict Scrutiny

It is thus clear that § 205(3) discriminates, either facially or as applied, in favor of Michigan wine wholesalers and against out-of-state companies, and must therefore pass the strict scrutiny test to survive. *Granholm*, 125 S Ct at 1907; *Heald*, 342 F3d at 525, citing *New Energy Co of Ind v Limbach,* 486 US 269, 278; 108 S Ct 1803; 100 LEd2d 302 (1988). To pass strict

[22] In support of their argument that there was a legitimate purpose for enacting § 205(3), i.e., to protect the middle tier of the wine distribution system.

scrutiny, the State has to demonstrate that the statute furthers a legitimate state interest unrelated to economic protectionism, and that there are no less discriminatory means for accomplishing the state's goals. Section 205(3) fails on both counts.

(a) Section 205(3) Fails Strict Scrutiny Because The Interest Identified By The State Is Protectionist

Bacchus and other Supreme Court opinions stand for the clear proposition that if a statute is protectionist, i.e., if the intent or effect was to protect local businesses from out-of-state competition, it must be declared violative of the Commerce Clause. A review of the evidence presented by Defendants leads to the inescapable conclusion that the purpose of § 205(3) was to protect local wine wholesalers.

This purpose is evident from the affidavit of Michael J. Lashbrooke, President of the MBWWA (Appendix 52a-59a), which states:

> 22. Section 205(3) recognizes that should an ADA/wholesaler be allowed to compete with a non-ADA wholesaler where there was no such competition prior to September 24, 1996, it would have a detrimental effect on Michigan's three-tier wine distribution system, potentially decreasing the number of wine wholesalers, and resulting in a few ADA/wholesalers dominating the distribution of wine in Michigan.
>
> * * * *
>
> 27. To summarize, in the highly regulated and complex wine distribution system that existed in 1996, § 205(3) sought to accomplish various goals, including: (i) to protect non-ADA wine wholesalers in the investment they made prior to the passage of the Spirits Privatization Act; (ii) to allow wholesalers who choose to become ADAs to keep the equity they had already established in the dual brands prior to privatization of spirits, but prohibit further dualing; (iii) to maintain a strong middle wine distribution tier with a number of different wholesalers; and (iv) to maintain an orderly market in wine by ensuring that retailers, and small retailers in particular, have products delivered to them by wholesalers.

This position was further supported by the affidavit of Nicholas Pavona who is Vice President of Classic Wines, Ltd., a licensed Michigan wholesaler of wine (Appendix 60a-62a). In that affidavit, submitted by Defendants, Pavona asserts that Classic Wines, Ltd. would not be able to compete with an ADA that was permitted to sell the same brands of wine that Classic Wines sold and that his company would probably go out of business if the law permitted ADAs to compete with regard to those brands of wine.

Finally, counsel for the MBWWA admitted in oral argument on its motion to intervene, that the MBWWA was very concerned because a decision declaring § 205(3) unconstitutional would make it difficult for "small wholesalers" to "compete" with ADA/wholesalers. Transcript from Motion to Intervene heard April 24, 2002, Appendix 43a. According to counsel for the MBWWA, "We...represent the wine wholesalers in Michigan...Should [§ 205(3)] be declared unconstitutional, it would have dire consequences for our members." *Id.* at 41a.

According to Defendants, the primary rationale for the passage of § 205(3) was to protect wine wholesalers in business on September 24, 1996, from competition from ADAs who also might want to become wine wholesalers, while at the same time protecting all the brands of wine then being sold by ADAs who were wholesalers on that date. The law could not be clearer that a statute designed to protect a local economy from competition does not further a legitimate state interest. Thus § 205(3) fares no better and cannot pass strict scrutiny.

(b) Section 205(3) Fails Strict Scrutiny Because The Statute Does Not Further The Stated Purpose—It Does Not Protect The Stability Of The Wholesale Market

It could never be in the State's interest to impair the ability of its ADAs to efficiently and cost-effectively warehouse and distribute state-owned cases of spirits. Such a statute would undermine the State's interest in having its spirits distributed effectively. Nevertheless, according to Defendants, the purpose of § 205(3) was to protect Michigan wine wholesalers from competition from companies who were ADA/wholesalers, thereby allegedly ensuring an adequate number of wholesalers to keep the market "stable." It ostensibly achieves this protection by prohibiting ADAs from dualing with regard to wines.[23]

A moment's reflection, however, leads inescapably to the conclusion that § 205(3) does not protect the wine distributors represented by the MBWWA from ADA/wholesalers, because it in fact *grants an exception from its prohibition on dualing* to every wine wholesaler who was marketing a particular brand of wine on September 24, 1996. Here, as noted in the Mauloff Affidavit (Appendix 122a-123a), the exception has already had the effect of swallowing the rule, as the two Michigan companies who are currently ADA/wholesalers handle 70% of the wine wholesale market in Michigan and therefore directly compete with the other wine wholesalers represented by the MBWWA. If there is a concern about the stability of the wholesale market – by which Defendants apparently mean there will be too few wholesalers for the market to be stable (Plaintiffs do not accept that stability is dictated by mere numbers) – because competition with ADA/wholesalers will be too great for the wholesalers causing them to quit the business, then it makes no sense to have included the exception for wines being sold on September 24, 1996. The practical effect of this exception is to guarantee that only two wine wholesalers will

[23] Defendants insist on referring to the fee received by an ADA from the State as a "subsidy," asserting that the State enacted § 205(3) to ensure that this "subsidy" would not give an ADA an unfair advantage over non-ADA wholesalers. This argument is a red herring. The fee received by ADAs is a fee given in exchange for services provided to the State. It is no different from any situation where the State buys services from a contractor. Here, the State owns cases of spirits that need to be warehoused and distributed. Prior to 1996, the State performed these functions with its own warehouses and employees. It "privatized" these functions by hiring private companies to provide the necessary services. A "subsidy" is a gift, not a fee for services. See Gove, *Webster's Third New International Dictionary* (Springfield, MA: Merriam-Webster Inc., 1986), Appendix 13a ("subsidy…d: a grant of funds or property from a government…to a private person or company to assist in the establishment or support of an enterprise deemed advantageous to the public ***either as a simple gift or a payment of an amount in excess of the usual charges for a service***…")(emphasis added). Defendants have offered no evidence to support their claim that the per case fee is a subsidy.

be left standing, as General and Transcon already had the lion's share of the wine business in 1996, and with the additional competitive edge of being an ADA as well, no one, except another ADA/wholesaler, would be able to compete with these giants.

In the context of the Commerce Clause, Defendants' stated purpose cannot survive the scrutiny which the law requires a court to bring to bear on any law which discriminates against interstate commerce. The *State* has the burden of "demonstrating" that its discriminatory law is necessary to further its stated purpose. This is in fact an "affirmative defense" that must be proven by the State. *Bainbridge v Turner*, 311 F3d 1104 (CA 11, 2002) at n 13; *Heald*, 342 F3d 517. The State has not met its burden, nor can it, as the logic of the above arguments proves. Even if one were to assume that protecting the middle tier of the wine distribution system was a legitimate state interest (it's not because it is a protectionist purpose), not only is § 205(3) not "necessary" to protect the stability of the middle tier, it actually threatens it in a significant way.

More importantly, for purposes of their motion for summary disposition, Defendants failed to present any evidence to support their affirmative defense that § 205(3) has or will further a core concern of the Twenty-first Amendment. To date, this statement has been pure speculation. The lower courts gave only lip service to the underlying principles of the Commerce Clause by accepting at face value the State's assertions and defenses concerning an orderly and stable wine wholesale distribution network. This is not enough to meet the State's obligations under the Commerce Clause. As noted by the *Heald* court:

> The district court's observation that "[t]he Michigan Legislature has chosen this path to ensure the collection of taxes from out-of-state wine manufacturers and to reduce the risk of alcohol falling into the hands of minors" and its conclusion that "the Twenty-first Amendment gives it the power to do so," without more, do not constitute strict scrutiny, as required by Supreme Court precedent. It is not enough that the Michigan Legislature has chosen this particular regulatory scheme to further what are legitimate

> objectives. The proper inquiry, detailed above, is whether it "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *New Energy Co of Ind v Limbach*, 486 US 269, 278 (1988). We find no evidence on this record that it does.

Heald, 342 F3d at 527.

Thus it is clear, even if protection of wine wholesalers was a legitimate state interest for purposes of a Commerce Clause analysis, § 205(3) fails to achieve this goal and therefore cannot withstand strict scrutiny under the Commerce Clause.

(c) Section 205(3) Fails Strict Scrutiny Because There Are Better Alternatives

If protection of wine wholesalers and the wholesale market had truly been the goal of § 205(3), this goal could have been much more effectively accomplished by just prohibiting ADAs from becoming wine wholesalers. If ADAs cannot wholesale wine, then the middle tier of the market would continue along just as it had successfully done prior to the passage of § 205(3). This would have been more fair to the ADAs as well, as they would not have to compete against other ADAs who have the incredible advantage of being able to dual wines which they were selling as of September 24, 1996. Thus there would be level playing fields in both the spirits and wine distribution systems and no danger of market instability. This was a simple and elegant solution to this alleged problem, one which the legislative history suggests was the original intention of the authors of the legislation. Senate Legislative Analysis, SB 1171(S-3), November 12, 1996, Appendix 14a-18a. This intention was apparently corrupted by the interests of the existing wine wholesalers who wanted the best of all worlds.[24] Senate Legislative

[24] The fact that the exception for existing *wine wholesalers* found its way into a statute that was privatizing the market for *distilled spirits* raises a strong inference that the exception was included in response to pressure from lobbying groups who were trying to protect wine wholesalers from out-of-state competition.

Analysis, SB 1171(S-3), November 12, 1996, Appendix 14a-18a. For this reason as well, under the strict scrutiny test, § 205(3) cannot stand.

It is therefore clear that § 205(3) must be declared unconstitutional because the interest identified by the State is protectionist, § 205(3) does not even advance the purpose identified by the State and there are simple, more effective alternatives that would in fact further that purpose that were rejected by the State.

(5) The Fact That Some Michigan ADAs Might Also Be Precluded From Dualing Does Not Save § 205(3) From Invalidity

Defendants asserted below that § 205(3) is not discriminatory because it applies equally to any ADA licensed after 1996, whether in-state or out-of-state. The trial court seemed to accept this conclusion. Transcript of Motion for Summary Disposition Hearing held August 14, 2002, Appendix 142a. This argument makes no sense as it ignores the favorable treatment given to all Michigan wholesalers who were selling wine on and before September 24, 1996. This purely in-state sector of the wine business received a huge benefit with the passage of § 205(3). Giving a one-time benefit to in-state businesses is still discrimination, even if the benefit is not offered to future in-state businesses. This is particularly true where, as here, the disadvantage to out-of-state businesses does continue, and where the advantage to the in-state businesses that received it gives them a competitive edge well into the future. Section 205(3) was, in effect, a gift to in-state wholesalers that keeps on giving.[25] The trial court and the Court of Appeals ignored this fact.

[25] In fact, it was a gift to the entire class of 40 or so wholesalers that were selling wines prior to September 24, 1996, even though only a handful of them have taken advantage of it to date. Nevertheless, each and every one of these wholesalers is entitled to seek appointment as an ADA at which point they would have a competitive edge over every out-of-state ADA. These in-state wholesalers could make this decision to enter the distilled spirits market at any time.

The United States Supreme Court has made it abundantly clear that a law that otherwise discriminates against interstate commerce is not redeemed merely because it has disadvantages for *some local* businesses as well. In *Fort Gratiot*, 504 US 353, the statute there declared unconstitutional essentially precluded counties from accepting waste generated anywhere but in that county. It was challenged by a landfill company that wanted to accept waste from non-county sources. The United States District Court for the Eastern District of Michigan refused to declare the statute in violation of the Commerce Clause because "[T]he statute does not discriminate against interstate commerce 'on its face' because the import restrictions apply 'equally to Michigan counties outside of the county adopting the plan as well as to out-of-state entities.'" *Fort Gratiot*, 504 US at 357-358. This is the same argument made by Defendants in the case at hand. The Supreme Court was not impressed:

> In *Dean Milk Co v Madison*, 340 US 349 (1951), another Illinois litigant challenged a city ordinance that made it unlawful to sell any milk as pasteurized unless it had been processed at a plant "within a radius of five miles from the central square of Madison," *id.* at 350. We held the ordinance invalid, explaining:
>
>> "[T]his regulation, like the provision invalidated in *Baldwin v Seelig, Inc*, [294 US 511, 55 (1935)], in practical effect excludes from distribution in Madison wholesome milk produced and pasteurized in Illinois. 'The importer ... may keep his milk or drink it, but sell it he may not.' *Id.* at 521. *In thus erecting an economic barrier protecting a major local industry against competition from without the State, Madison plainly discriminates against interstate commerce.*" *Id.*, at 354.
>
> *The fact that the ordinance also discriminated against all Wisconsin producers whose facilities were more than five miles from the center of the city did not mitigate its burden on interstate commerce.* As we noted, it was "immaterial that Wisconsin milk from outside the Madison area is subjected to the same proscription as that moving in interstate commerce." *Id.* at 354, n 4.
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> * * * *
>
> In short, neither the *fact that the Michigan statute purports to regulate intercounty commerce in waste* nor the fact that some Michigan counties accept out-of-state waste provides an adequate basis for distinguishing this case from *Philadelphia v New Jersey* [where the Court struck down a similar waste statute].

Fort Gratiot, 504 US at 362-363. (emphasis added). See also *Carbone*, 511 US at 391-392 ("The ordinance is no less discriminatory because in-state or in-town processors are also covered by the prohibition...The only conceivable distinction from the cases cited above is that the flow control ordinance favors a single local proprietor. But this difference just makes the protectionist effect of the ordinance more acute.")

There is no reason to distinguish between *Fort Gratiot* or *Carbone* and the instant case. The mere fact that § 205(3) may negatively impact post-1996 Michigan companies that want to become ADA/wholesalers is completely irrelevant to the question of whether it discriminates against out-of-state companies who wish to do the same. Just as in *Carbone*, there is a distinct implication that § 205(3) was passed to favor its two primary beneficiaries, Transcon and General, which just makes its "protectionist effect . . . more acute." Because the statute undeniably discriminates in this manner, it must pass strict scrutiny before it can be upheld. As shown above, § 205(3) cannot meet this standard.

Thus it is clear that § 205(3) does discriminate against interstate commerce. It should be declared invalid.

b. Section 205(3) Fails the Undue Burden Test

Even if this Court were to determine that § 205(3) is not discriminatory, it should still declare the statute in violation of the Commerce Clause because it places an undue burden on interstate commerce without good reason. This test was succinctly stated by the Supreme Court in *Pike v Bruce Church, Inc,* 397 US 137, 142; 90 S Ct 844; 25 L Ed 2d 174 (1970):

> Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such

> commerce is clearly excessive in relation to the putative local benefits.

Stated in another way, if the state law does not discriminate, it will still violate the Commerce Clause if it does not effectuate "a legitimate local interest," its affect on interstate commerce is more than incidental or if its burden on interstate commerce outweighs the putative local benefits. See also *Raymond Motor Transp, Inc v Rice,* 434 US 429, 441; 98 S Ct 787; 54 L Ed 2d 664 (1978)("Our recent decisions make clear that the inquiry necessarily involves a sensitive consideration of the weight and nature of the state regulatory concern in light of the extent of the burden imposed on the course of interstate commerce.")

As discussed above in the context of the discrimination test, a law that is designed to protect local businesses from out-of-state commerce is likewise automatically determined to violate the Commerce Clause.

> The opinions of the Court through the years have reflected an alertness to the evils of "economic isolation" and protectionism, while at the same time recognizing that incidental burdens on interstate commerce may be unavoidable when a State legislates to safeguard the health and safety of its people. Thus, where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected. . . The crucial inquiry, therefore, must be directed to determining whether ch. 363 is basically a protectionist measure, or whether it can fairly be viewed as a law directed to legitimate local concerns, with effects upon interstate commerce that are only incidental.

City of Philadelphia v New Jersey, 437 US 617, 623-624; 98 S Ct 2531; 57 L Ed 2d 475 (1978). See also *H P Hood & Sons, Inc v Du Mond,* 336 US 525, 532; 69 S Ct 657; 93 L Ed 865 (1949)("It recognized, as do we, broad power in the State to protect its inhabitants against perils to health or safety, fraudulent traders and highway hazards even by use of measures which bear adversely upon interstate commerce. But it laid repeated emphasis upon the principle that the

State may not promote its own economic advantages by curtailment or burdening of interstate commerce.")

Here, it is admitted that the purpose underlying § 205(3) was to protect wine wholesalers and pre-1996 ADA/wholesalers from legitimate competition. Affidavit of Michael J. Lashbrook, Appendix 56a-57a. This is not a case where the state is seeking to "protect its inhabitants against perils to health or safety." *H P Hood,* 336 US 525. There are no social welfare concerns advanced by § 205(3), nor do Defendants contend as much. The rationale offered to this Court is that certain local businesses will lose an economic advantage that § 205(3) indisputably gives them. That's it. One group's economic interests are promoted at the expense of another. That is the textbook definition of protectionism. This is not a legitimate interest and § 205(3) cannot be allowed to stand.

Nor does the fact that this statute involves alcoholic beverages somehow rescue it from invalidity. Plaintiffs contend that a careful reading of *Granholm* leads to the conclusion that the Twenty-first Amendment no longer affords a basis for distinguishing between Commerce Clause cases. If a statute discriminates against or places an undue burden on interstate commerce, it is evaluated the same whether it involves alcoholic beverages, interstate trucking or waste disposal services.

Nevertheless, even if this Court were to determine that a legitimate state interest can somehow arise from the Twenty-first Amendment where a state law impedes interstate commerce, no such interest is implicated here. For example, a number of cases have agreed that promotion of temperance is a core concern that was addressed by adoption of the Twenty-first Amendment. See *CA Dickerson v Bailey*, 212 F Supp 2d 673, 674 (SD TX, 2002) ("*Dickerson I*"); *North Dakota v United States*, 495 US 423, 432, 110 S Ct 1986, 109 L Ed 2d 420 (1990); *Pete's Brewing Co v Whitehead*, 19 F Supp 2d 1004, 1018 (WD MO, 1998) ("A state's desire to promote temperance is clearly legitimate pursuant to the Twenty-first Amendment."). This makes complete sense as this amendment was in effect reversing the ultimate temperance enactment—prohibition. While the Twenty-first Amendment did away with prohibition, in its place, states were given the authority to adopt laws to promote temperance as a means for protecting the health and safety of their citizenry. Courts have also identified other core concerns underlying the Twenty-first Amendment, for example, permitting states to raise revenue from the sale of alcoholic beverages, *Dickerson I*, 212 F Supp 2d at 696; *Bainbridge v Turner*, 311 F3d 1104, 1115 (CA 11, 2002), and ensuring "orderly markets," *id.; Dickerson I*, 212 F Supp 2d at 696; *Pete's Brewing Co,* 19 F Supp 2d at 1019; and *North Dakota,* 495 US at 432.

Protecting the stability of the middle tier does not implicate a core concern of the Twenty-first Amendment. It does not promote temperance (and would arguably have the opposite effect), it does not raise revenues, and it does not ensure orderly markets as that term is generally used in the context of the Twenty-first Amendment. As noted above in the Statement of Facts, the alcoholic beverage market was made "orderly" by the implementation of tied-house laws that kept the manufacturing, wholesaling and retailing tiers completely separate from each other. The purpose of this separation was to prohibit manufacturers from having too much influence over the sale and distribution of their products, apparently with the idea of protecting consumers from prices that were too high (gouging) or too low (promoting intemperance and dependence that then opened the door to gouging). Thus, any statute that is directed toward this separation of the tiers of the distribution system arguably could have some effect on "orderly markets."

Section 205(3), however, only deals with the occupants of the middle tier of the distribution system. It does not address the separation of the three tiers, and really does not affect the system as a whole. Although Defendants assert that it is designed to promote "orderly markets," it protects only the individual licensees of one level of the system, and does not ensure orderly markets as that phrase is used in Twenty-first Amendment cases.[26]

The decision in *California Retail Liquor Dealers Ass'n v Midcal Aluminum, Inc*, 445 US 97; 100 S Ct 937; 63 L Ed 2d 233 (1980) is particularly on point here as the proponents of the resale price maintenance schedules in that case made the same arguments as Defendants in the case at hand. In *Midcal* the stated purpose of the resale price maintenance scheme was "protect[ing] small licensees from predatory pricing policies of large retailers." *Id.* at 112. In the case at hand, Defendants contend that § 205(3) was enacted to protect small wine wholesalers who could not compete against ADAs/wholesalers, thus promoting "orderly markets." Defendants' Brief in Support of Joint Motion for Summary Disposition, Appendix 99a. In *Midcal,* the proponents of the illegal scheme also claimed that it promoted "orderly markets" (a concern identified by the trial court in the instant case, Tr. May 8, Appendix 81a). If the Twenty-first Amendment did not preclude the *Midcal* Court from striking down the resale price maintenance scheme where the state concerns identified were identical to those expressed here, there is no reason why it should aid Defendants in the case at hand.

If there were any doubt that protectionism is not a legitimate state purpose, even when alcoholic beverage regulation is concerned, it was put to bed by the Supreme Court in the *Bacchus* case. "The central purpose of [the Twenty-first Amendment] was not to empower States to favor local liquor industries by erecting barriers to competition...State laws that constitute mere economic protectionism are therefore not entitled to the same deference as laws

[26] The court in *Bainbridge* noted: "As for 'ensuring orderly markets,' we are not sure what that phrase means, but it certainly does not mean discrimination in a way that effectively forecloses out-of-state firms from the Florida market." *Bainbridge*, 311 F3d at 1115. The same can be said here.

enacted to combat the perceived evils of an unrestricted traffic in liquor." *Bacchus,* 468 US at 276.

2. The Commerce Clause Protects Out-of-state Providers of Services as Well as Out-of-state Products

Defendants have asserted a new argument in response to this appeal. Defendants contend that the Commerce Clause does not protect out-of-state providers of services. This argument is easily dispatched by reference to the numerous Commerce Clause cases involving interstate trucking services. See *Raymond Motor, supra* (Court invalidates state law restricting truck size); *Kassel v Consolidated Freightways Corp*, 450 US 662; 101 S Ct 1309; 67 LEd2d 580 (1981)(Court invalidates state law restricting truck size). Obviously, trucking companies provide only a service, much like an ADA/wholesaler that warehouses and distributes a product. If the Commerce Clause can be used to invalidate a law that puts restrictions on interstate truckers, it can also ban a statute that puts limits on an out-of-state company that distributes alcoholic beverages. See also *Carbone* and *Fort Gratiot, supra,* where the Supreme Court invalidated a law that prohibited out-of-state waste companies from providing services to a local municipality ("Whether the business arrangements between out-of-state generators of waste and the Michigan operator of a waste disposal site are viewed as "sales" of garbage or "purchases" of transportation and disposal services, the commercial transactions unquestionably have an interstate character. The Commerce Clause thus imposes some constraints on Michigan's ability to regulate these transactions." *Fort Gratiot*, 504 US at 359.

The Defendants' last ditch attempt to distinguish the case at hand from the overwhelming Commerce Clause authority that would find it unconstitutional cannot be taken seriously.

III. ON ITS FACE § 205(3) DENIES PLAINTIFFS THE EQUAL PROTECTION OF THE LAW

As shown above, § 205(3) discriminates against a certain class of business. This discrimination also violates the Equal Protection Clauses of the United States and Michigan Constitutions because there is no rational basis for it. Its sole purpose is to protect local entities. The Courts have consistently ruled that such a purpose, without more, is unconstitutional.

A. General Requirements of Equal Protection

The Fourteenth Amendment to the U.S. Constitution states "...nor shall any State ...deny to any person within its jurisdiction the equal protection of the laws." Likewise, art. I, § 2 of Const. 1963 states that "No person shall be denied the equal protection of the laws...." These two constitutional provisions guarantee that every citizen will be treated equally under the law. This generally means that any law or government action which treats a class of citizens differently – whether imposing a restriction or providing a benefit – will be scrutinized to determine whether there is a good reason for making a distinction between those citizens. Where no fundamental right is implicated, for such a distinction to survive constitutional attack, it must bear a rational relationship to a legitimate state purpose. *Massachusetts Board of Retirement v Murgia*, 427 US 307; 96 S Ct 2562; 49 L Ed 2d 520 (1976).

Courts generally employ a two-step process when analyzing statutes challenged on equal protection grounds. First, they attempt to identify the purposes of the statute and determine whether those purposes are legitimate. Second, having identified the governmental purposes as legitimate, courts then must determine whether the distinction between classes is rationally related to the achievement of the legitimate state interest. *Penn Mut Life Ins Co v Department of Licensing and Regulation*, 162 Mich App 123, 130; 412 NW2d 668 (1987) ("...the test is (1) does the legislation have a legitimate state purpose and (2) was it reasonable for lawmakers to believe that use of the challenged classification would promote that purpose.")

B. Application of Equal Protection To § 205(3)

1. Section 205(3) Creates Two Classes Based on the Arbitrary Date September 24, 1996

In the case at hand, § 205(3) defines two obvious classes, i.e., ADAs who were wine wholesalers before September 24, 1996, and ADAs who were not. It then treats these two classes differently by imparting a benefit to the pre-1996 class that is not available to the post-1996 class.

2. Section 205(3) Fails the first Prong of the Equal Protection Test Because Protectionism Is Not A Legitimate State Purpose

Plaintiffs have been unable to imagine a legitimate state purpose for creating these two classes distinguished only by the date September 24, 1996. Nor does there appear to be a logical connection between this date and any underlying policy supporting § 205(3). The statute itself (1996 PA 440) did not become effective until December 19, 1996 so this is not a situation where a change was made on the effective date of the legislation. Everything about this statute and the way it was adopted suggests that this was an arbitrary date selected solely for the purpose of protecting existing local wine wholesalers who would be given an unfair competitive advantage over any future ADA who would not effectively be able to wholesale wine while acting as an ADA.

Just as argued above in the context of the Commerce Clause, no state has a legitimate interest in protecting one class of business from competition by another class. This was recently confirmed by the U.S. Court of Appeals for the Sixth Circuit:

> Courts have repeatedly recognized that protecting a discrete interest group from economic competition is not a legitimate governmental purpose. *See City of Philadelphia v New Jersey,* 437

> US 617, 624; 98 S Ct 2531; 57 LEd 2d 475 (1978) ("Thus, where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected."). *See also H.P. Hood & Sons, Inc. v Du Mond,* 336 US 525, 537-38; 69 S Ct 657; 93 LEd 865 (1949); *Energy Reserves Group, Inc. v Kansas Power & Light Co.,* 459 US 400, 411; 103 S Ct 697; 74 LEd 2d 569 (1983).

Craigmiles v Giles, 312 F3d at 224. In *Craigmiles*, the court held that a statute that prohibited anyone but a licensed funeral director from selling a casket violated the Equal Protection clause because there was no legitimate state interest is protecting the funeral directors from competition from other businesses that might sell a casket. The court specifically noted that, even under the rational basis test, this type of protectionism could not be allowed to stand. *Id.* at 228-229. Creating an effective monopoly for one class of participants is not constitutional.

There is no difference between the law restricting the sale of caskets and § 205(3). It is admitted by Defendants that the purpose of the law was to restrict competition in favor of wine wholesalers from ADA/wholesalers. Of course, the law fails even in this purpose as it allows any wine wholesaler who becomes an ADA to bypass the restrictions that are intended to protect the rest of the wine wholesalers, as long as the wine wholesaler/ADA was selling wines before 1996.

Likewise, the purpose of protecting the "investment" of the pre-1996 ADA/wholesalers in their wine brands (Affidavit of Michael J. Lashbrook, Appendix 52a-59a) is also a blatant protectionist purpose. Why should these ADA/wholesalers get special treatment when ADA/wholesalers who did not sell wines before 1996 do not? Just as in *Craigmiles*, it is clear that the law was designed to further the interest of one group of wholesalers at the expense of others. For this reason alone, § 205(3) should be declared unconstitutional as it does not pass the first prong of the Equal Protection test.

The U.S. Supreme Court has similarly held that economic protectionism is not a legitimate state interest. In *Mayflower Farms v Ten Eyck*, 297 US 266, 275; 56 S Ct 457; 80 L Ed 675 (1936), which involved milk dealers, the Court concluded that the statute in question was passed in "an attempt to give an economic advantage to those involved in a given business at an arbitrary date as against all those who entered the industry after that date." The Court specifically held that it could discern no legitimate state purpose for setting up classifications of milk dealers who sold milk before a particular date as opposed to milk dealers who sold milk after that date. *Id.*

The provision at issue in *Mayflower Farms* was intended to regulate milk prices for the general public benefit. It allowed dealers who sold milk prior to the date specified in the statute to charge $.01 less per quart than similar dealers who came into the market after that date. The Court noted that the practical effect of the law was to preclude anyone from entering the milk business after the specified date as they would be unable to compete with those dealers who enjoyed the benefit of selling at the lower price.

The milk law that was declared unconstitutional in *Mayflower Farms* is identical in its operation to § 205(3). Both statutes confer an economic advantage not previously enjoyed by a class of the regulated community, merely because that class existed prior to a specified date. Both statutes select a date which existed prior to the effective date of the statute creating the benefit. Both statutes effectively ensure that other similarly situated members of the regulated community that do not enjoy the benefit will not be able to compete as a practical matter as a result of the statute. The Court in *Mayflower Farms* recognized that the statute regulating milk dealers was not a legitimate grandfather provision which would regulate a business or activity "in the interest of, or for the protection of, the public", *Id.* at 274, but was rather an attempt to give an economic advantage to those engaged in the business on an arbitrary date as against all those who entered the industry after that date. Section 205(3) also is not a legitimate grandfather clause as it gives a new benefit (as opposed to not taking away an existing right or status) to Michigan wine wholesalers who were in business on September 24, 1996, while denying that benefit to wholesalers licensed after that date (see argument *infra*). There is no basis for distinguishing § 205(3) from the milk statute in *Mayflower Farms* and just as that statute was declared unconstitutional, § 205(3) should be declared unconstitutional in violation of the equal protection clauses of the United States and Michigan Constitutions.

3. Section 205(3) Fails the Second Prong of the Equal Protection Test Because There Is No Rational Basis for § 205(3)

a. Michigan Law Rejects Arbitrary Classifications

There are numerous examples in Michigan case law where the courts have found statutes unconstitutional as violative of equal protection because they do not rationally distinguish between favored and unfavored classes. One case which is particularly instructive is *Hertel v Racing Com'r, Dept of Agriculture*, 68 Mich App 191; 242 NW2d 526 (1976). In that case, legislation provided funding to any stadium authority organized "before December 1, 1971." *Id.* at 196. When the law was passed, everyone knew that only the Pontiac Stadium Authority met this restriction. The Court of Appeals had no trouble seeing the error in such legislation:

> We do find, however, one part of the statute to be constitutionally defective. Appropriations under the act are limited to stadium authorities which were organized before December 1, 1971. As a practical matter, the class created by the act was narrowed by the time limit to one city--Pontiac, as it maintains the only existing stadium authority which was created by that date. There is nothing wrong per se with the fact that one city alone benefits from legislation. But the act creates a class of several members who are entitled to equal treatment. *Class legislation must be '(U)niform in its operation upon all persons of the class to which it naturally applies; but if it fails to include and affect alike all persons of the same class, and extends immunities or privileges to one portion and denies them to others of like kind, by unreasonable or arbitrary sub-classification, it comes within the constitutional prohibition against class*

> *legislation.*' *Haynes v Lapeer Circuit Judge*, 201 Mich 138, 141-142; 166 NW 938, 940 (1918). [footnote omitted]
>
> It is generally recognized that local classifications must be created ***so as to include future members who might qualify and they may not be based on existing circumstances only so as to exclude members of the class who might qualify in the future***. [FN8]
>
> FN8. See 16 Am Jur 2d, Constitutional Law, s 503 and cases cited therein.
>
> No rational basis has been demonstrated for distinguishing between stadium authorities created before December 1, 1971 and those that may be created thereafter. Such time limitation, therefore, is unconstitutional. We find the provision, however, to be severable; [footnote omitted] the remainder of 1972 P.A. 5 is valid.

Hertel, 68 Mich App at 199-200. (emphasis added).

This is the same situation as in the case at hand. Section 205(3) picks an arbitrary date by which the huge benefit of being able to effectively "dual" is awarded to a limited class of players, i.e., those who were already selling brands of wine on September 24, 1996. Thus, any ADA that did not obtain a wine wholesaler's license prior to that date is completely out of luck. There is no reason why "future members" – ADAs who become wine wholesalers after September 24, 1996 – should be excluded from the benefits of this legislation, any more than the stadium authorities organized after December 1, 1976 could be denied financing in the *Hertel* case. Just as the legislation in *Hertel* was patently designed to protect a limited class and was therefore unconstitutional, § 205(3) was designed to give existing wine wholesalers the enormous advantage of being able to sell wine and spirits, while precluding latecomers from competing on level ground. It must also be declared unconstitutional.[27]

In another Michigan case, *Beauty Built Const Corp v City of Warren*, 375 Mich 229; 134 NW2d 214 (1965), the plaintiffs sought a declaration that an ordinance passed by the city created two classes of citizens and treated one of the classes unfairly. The ordinance in question

[27] In *Hertel* the offending language was severed from the statute. The same result should occur here.

imposed a sewer tap charge on all construction completed after a specified date. In finding the ordinance unconstitutional, the Court stated:

> This Court has repeatedly held that classification of objects to which a municipal ordinance may be made applicable must be based on natural distinguishing characteristics and must bear a reasonable relation to the object of the ordinance. See *Palmer Park Theatre Company v City of Highland Park*, 362 Mich 326; 106 NW2d 845 [(1961)]; *Mulloy v Wayne County Board of Supervisors*, 246 Mich 632; 225 NW 615 [(1929)].
>
> Where an ordinance fails to include and affect alike all persons of the same class, and extends immunities or privileges to one part and denies them to others of like kind by unreasonable or arbitrary classification, the same is contrary to the equal protection guarantees of the State and Federal Constitutions. See *Haynes v Lapeer Circuit Judge*, 201 Mich 138; 166 NW 938; LRA 1918D, 233 [(1918)].
>
> In the case before us no reasonable or rational foundation has been submitted to support the exemption and classification created by the ordinance. The date January 13, 1959, seems to have been chosen simply because it was the date defendant city decided to begin raising additional revenues. It certainly was not chosen because it formed a reasonable or rational date for establishing a division of a class.

Beauty Built, 375 Mich at 235-236.

In the case at hand, the same can be said for the decision to "extend immunities or privileges" to wine wholesalers who were licensed before September 24, 1996. September 24, 1996 is not "a reasonable or rational date" for creating a distinction between ADAs who also wish to wholesale wine. In *Beauty Built* at least the selection of the date was motivated by nothing more than convenience; in the case at hand it would appear that this decision was calculated to preclude a segment of the industry from conducting a business in Michigan.[28] At any rate, *Beauty Built* makes it clear that arbitrary and irrational discrimination cannot be

[28] This is admitted by Defendants who told the trial court that the date was purposely selected to pre-date the enactment of the statute so that those licensees who did not already have significant brands of wine before the cut-off date could not "rush" to try to pick up as many brands of wine as they could. Tr. May 8, Appendix 68a-70a.

condoned by the State. See also *Stimson v Muskegon Booming Co,* 100 Mich 347; 59 NW 142 (1894)(Court declares unconstitutional statute which permits company that has sustained losses to collect larger toll than a company that has been profitable, noting, "This is class legislation…It is not possible that…the legislature…confer upon one corporation rights which, under precisely similar circumstances, it denies to another, or greater rights and privileges upon one than are conferred upon another."); *Palmer Park Theatre Co v City of Highland Park*, 362 Mich 326, 106 NW2d 845 (1961) (Court declares legislation unconstitutional that taxes users of air conditioning equipment using over five tons of water, but not units using less than five tons, stating, "The classification must be based upon substantial and real differences in the classes, which are germane to the purpose of the law and reasonably suggest the propriety of substantially different legislation….").

b. Classifications Based On Domestic vs. Foreign Violate Equal Protection

As noted above, when § 205(3) and § 601 are read together, the effect is that the only ADAs permitted to dual with regard to wines are Michigan companies. Not only does this scheme violate the Commerce Clause, it also violates Equal Protection because it favors one class, domestic wholesalers, over another class, foreign wholesalers. This "domestic/foreign" dichotomy has been addressed by numerous courts:

> We hold that, unlike in *Ward* [*Metropolitan Life Ins Co v Ward*, 470 US 869 (1985)], the purpose advanced by the state is legitimate (i.e., making insurance coverages available to residents), but the means chosen are not rationally related to promoting that purpose. The classification scheme is based on residency. Although it is not required that close distinctions be drawn in making classifications, the foreign/domestic classification scheme made here affords no opportunity for a foreign insurer to share in the tax preference given to domestic insurers if it desires to offer insurance in the areas of greatest public need despite the lower profit potential. The classification scheme also permits a domestic insurer to obtain a tax preference over foreign insurers even if the line of insurance offered is in a more lucrative market. Thus the classification is both under and over

inclusive and not rationally related to promoting insurers to offer insurance in the high loss ratio areas such as medical malpractice, farm owners multiple peril, liquor liability, municipal liability, and product liability.

If the state's purpose is broader than just providing insurance in hard-to-insure markets and instead encompasses the general purpose of encouraging the creation of domestics, we would find the purpose was not legitimate, based on Ward. The taxing scheme does, in fact, ***seem more rationally related to promoting domestics*** than to encouraging insurance companies to provide policies in the less lucrative areas. There is no indication that taxing domestic companies more, or foreign companies less, would change the fact that foreign companies are less likely to provide insurance in high loss categories and domestics will see an open market and provide the insurance. The taxes imposed do not serve as an incentive to provide insurance in high loss categories.

We, therefore, find that the taxing scheme presently used is unconstitutional...

Penn Mutual Life Ins Co, supra at 132 (emphasis added). Likewise, § 205(3) clearly is "more rationally related" to protecting the economic interests of a few Michigan ADA/wholesalers than ensuring the stability of the middle tier of the wine distribution system. See also *Williams v Vermont*, 472 US 14, 22; 105 S Ct 2465; 86 L Ed 2d 11 (1985)("Whatever the general rule may be, to provide a credit only to those who were residents at the time they paid the sales tax to another State is an arbitrary distinction that violates the Equal Protection Clause."). In *Williams*, the state of Vermont gave residents who bought a car in another state an exemption from its use tax, while denying the same exemption to non-residents. This is comparable to § 205(3) which gives an exemption to Michigan wholesalers from the newly imposed limitation on dualing to the extent they were selling a brand of wine prior to September 24, 1996. This benefit went only to Michigan residents because of the requirements of § 601. It is therefore unconstitutional.

c. Section 205(3) Does Not Protect Wine Wholesalers

The lower courts seemed to accept Defendants' explanation that § 205(3) was designed to protect small wine wholesalers from competition by ADA/wholesalers. As noted above, accepting the explanation does not make it constitutional because such a protectionist purpose is not a legitimate state interest.

Even if this were a legitimate state purpose, a moment's reflection reveals the fallacy of the contention that § 205(3) protects the mom and pop wine wholesalers. If the Legislature truly believed there was some evil in having combined operators in Michigan, it could have easily addressed the problem without impinging on the rights of the existing wine wholesalers by merely passing a law which would not permit *anyone* to be both an ADA and a wine wholesaler. Existing wine wholesalers could continue to conduct their business just as they had done before with no adverse impact from the legislation. They would be competing only with other wine wholesalers just as they had always done.

Likewise, the newly created ADAs could operate their businesses and would be in competition only with other ADAs. If there is such an evil to combined operators, this sort of legislation would have solved the problem, provided a level playing field for all the businesses involved, and would have created no hardships for any existing businesses. Section 205(3), of course, eschewed this approach in favor of giving a huge advantage to existing wine wholesalers. As there is no rational basis for the scheme adopted by § 205(3), and since it unfairly discriminates against ADAs who were not licensed wine wholesalers before September 24, 1996, it must be declared unconstitutional.

4. Summary Disposition Based On Equal Protection Was Warranted

Plaintiffs initial motion for summary disposition was brought pursuant to MCR 2.116(C)(10) as there was no dispute with regard to any material issue of fact. The only issue for the trial court to determine was whether § 205(3) should be declared unconstitutional as a matter of law. *Stevenson v Reese,* 239 Mich App 513, 516; 609 NW2d 195, (2000) ("The constitutionality of a statute is a question of law that we review de novo."); *Michigan State*

Employees Ass'n v Liquor Control Com'n, 232 Mich App 456, 463; 591 NW2d 353 (1998). Defendants deny that the statute violates the constitutional proscriptions, but for the reasons set forth above, Plaintiffs believe that the court should have declared that § 205(3) is unconstitutional.

IV. Section 205(3) is not a "Grandfather Clause"

The trial court and Court of Appeals found that § 205(3) is a "grandfather clause" of the sort sometimes found in federal and state legislation, and held that because of this it was not unconstitutional. The point the courts missed is that merely calling something a "grandfather clause" ***does not mean that it does not have to comply with the constitution***, including the Equal Protection and Commerce clauses. *Peoples Rights Organization, Inc, v City of Columbus*, 152 F3d 522, 531 (CA 6, 1998). As shown above, § 205(3) violates the Constitution and cannot be validated, whether it is called a grandfather clause or not.

Section 205(3), however, is not even a "grandfather clause" as that term is generally used in the law. The typical grandfather clause is found in a statute imposing a new restriction on a regulated group. The grandfather clause allows the group members currently possessing some status to retain that status even though they do not comply with the new restriction. It is sometimes legitimate for a state to honor the "reliance" interest that a group member may have in the state of the law pre-dating the relevant change. *Id.* For example, a few years ago, lawyers who were admitted to the Michigan Bar prior to a certain date were not required to attend continuing legal education courses ("CLE"), while attorneys admitted after that date were required to satisfy the annual requirement. The first category of attorneys were "grandfathered" and could retain their licensed status without complying with the new law. Grandfather clauses are essentially a compromise – the law is changed to add restrictions to benefit the general public welfare, while at the same time not imposing too harsh a burden on existing members of the regulated community who selected a career or business, or made other decisions in reliance on a certain state of the law.

This is far different from the situation at hand. ***Section 205(3) placed no new restrictions on the operations of existing wine wholesalers.*** They therefore did not need the protections of a grandfather clause as they had no "reliance" interest in becoming an ADA as there were no ADAs until the statute was passed. Unlike the lawyer who would have had to comply with the CLE requirements or stop practicing law (but for the operation of the grandfather clause), existing wine wholesalers were able to continue operating exactly as they had before § 205(3) was passed. Wine wholesalers could become ADAs if they wanted to, but they did not have to become ADAs to maintain their status as wine wholesalers. The sole effect of § 205(3) was to give existing wine wholesalers an *additional benefit* that they had never before enjoyed, i.e., the right to be both a wine wholesaler ***and*** an ADA. *In fact, there were no ADA/wholesalers at the time § 205(3) was enacted, so there was no one that could be grandfathered!* It was only when wine wholesalers made the voluntary choice to apply for the newly-created position of ADA/wholesaler that § 205(3) imposed any restrictions on their operation. If they did not choose to become ADAs they suffered no burden at the hands of § 205(3). It is thus clear that § 205(3) is not a grandfather clause.

The trial court's explanation of why § 205(3) is a grandfather clause, even though it imposes no restrictions on wine wholesalers, is difficult to understand. Judge Glazer stated that wine wholesalers should be able to become ADAs without losing the benefit of the business that they had developed and the investment they had made. What he did not acknowledge is that no wine wholesaler was in any danger of losing that business *unless it voluntarily elected to become an ADA.* Thus, the extraordinary circumstance of the government imposing new rules in the

MILLER, CANFIELD, PADDOCK AND STONE, P.L.C.

middle of the game did not occur here. The new law created another business opportunity for wine wholesalers – and its attendant restrictions on dualing – only *if they chose to accept it.*

The Court of Appeals was even more confused in its desire to find a legitimate grandfather clause. Plaintiffs argued that the right to be an ADA/wine wholesaler was newly conferred by the privatization law, and could not be the basis of a true grandfather clause. The Court of Appeals disagreed, noting "[a] wine wholesaler could become an ADA both before and after September 24, 1996," Appeal opinion, p. 6, apparently contending that the pre-1996 ADAs should be grandfathered. This statement is patently erroneous, as recognized by the Court of Appeals itself in the ***immediately preceding*** paragraph where it noted "Before 1996, there were no ADAs…" This initial conclusion of the Court of Appeals was correct because, in fact, ADAs could not exist until the effective date of the statute, December 19, 1996. Thus, this is not a legitimate grandfather clause.

CONCLUSION

For these reasons, Plaintiffs respectfully request that this Court reverse the lower courts' decision granting Defendants' joint motion for summary disposition and refusing to grant Plaintiffs' motions for summary disposition.

Respectfully submitted,

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